

6.2 Externalities

Name: _____ Class: _____ Date: _____

Total: 8 marks

KEY WORDS externality 外部性 • negative externality 负外部性 • pigouvian tax 庇古税
 • positive externality 正外部性 • socially efficient 社会有效率

Objective

Build the skills to answer exam questions on **externalities**.

You must be able to:

- define an **externality** 外部性 as a cost or benefit on a third party
- distinguish a **negative externality** 负外部性 from a **positive externality** 正外部性
- show how a negative externality causes **overproduction** and a positive one **underproduction**
- evaluate corrective policies: a **Pigouvian tax** 庇古税, a subsidy, and tradable permits

1 Worked examples

Study these first. Each one shows the method for a question type used later.

■ Externalities

A **cost or benefit** that falls on a third party outside a market transaction.

- **Negative** (e.g. pollution): marginal social cost exceeds private cost → the market **overproduces**.
- **Positive** (e.g. vaccination): marginal social benefit exceeds private benefit → the market **underproduces**.

Either way there is a **deadweight loss** compared with the socially efficient outcome.

■ Corrective policy

A **Pigouvian tax** on a negative externality, a **subsidy** for a positive one, or **tradable permits**.

2 Practice

2.1 Define an externality. [1]

2.2 State whether a negative externality causes over- or under-production. [1]

2.3 Name a policy to correct a negative externality. [1]

3 Exam-style questions

3.1 A negative externality causes the market to [1]

- **A** underproduce
- **B** overproduce
- **C** produce the efficient amount
- **D** stop producing

3.2 A tax set equal to the external cost of a good is called a [1]

- **A** tariff
- **B** Pigouvian tax
- **C** subsidy
- **D** quota

3.3 A factory pollutes a river, harming nearby residents.

- (a) Name the type of externality. [1]
- (b) State whether the market over- or under-produces. [1]
- (c) Name a corrective policy. [1]

Solutions

2.1 a cost or benefit that falls on a third party outside the transaction.

2.2 overproduction.

2.3 a Pigouvian tax (or tradable permits).

3.1 B.

3.2 B.

3.3 (a) a negative externality. (b) it overproduces. (c) a Pigouvian tax (or tradable permits).